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FINANCIAL DIAGNOSIS OF THE COMPANY BASED ON THE INFORMATION DERIVED FROM THE BALANCE SHEET. CASE STUDY

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Abstract

The role of the balance sheet in the financial diagnosis of the company derives from the fact that it serves to determine the financial security margin through the working capital, which allows the company to face the short-term risks, guaranteeing its solvency. Based on these considerations, we elaborated this paper based on the information gathered from a commercial company with an agricultural profile by emphasizing the balance indicators based on the financial balance, namely: the net working capital, the working capital requirement, the net treasury, the net situation of the company. The sources of information for this paper were the company annual financial and accounting statements for the period 2015-2017. As a method, the comparative financial analysis was used, more specifically, the analysis of the company results based on the company balance sheet. The positive and growing net position highlights a sound economic management as a result of reinvesting part of the net profit and other capital items.

Key words: *financial balance, working capital, profit, net situation, net treasury*

INTRODUCTION

In general terms, *the balance sheet* expresses the patrimonial situation at the end of the financial year. However, the accounting document that expresses how it reached the ultimate patrimonial situation, which were the income and expenses flows that marked the evolution of the enterprise between the beginning and the end of the financial year, represents the profit and loss account. The balance sheet is the brief accounting document which presents the assets and liabilities (means and resources) at the end of the year and in other situations stipulated by law, grouped by nature, destination and liquidity, respectively by nature, origin and exigibility (Coşea and Nastovici, 2007, Mironiuc, 2011) [3, 9]. The liabilities refer to the funds received by the enterprise (shareholders own funds, provisions, operating liabilities, financial liabilities), and those assets, the use of these funds on a durable basis (fixed assets) and on a temporary and cyclical basis (current assets).
Assets and liabilities reflect the same reality as means of financing and their use at the same time, which imposes the permanent balance between the assets and liabilities of the balance sheet, regardless of the form of presentation (table or list).
The agricultural company, as an independent economic and social body, has as main objective to obtain profit. By comparing the *effort* made by the company (company), measured by the accountancy by the amount of *expenses*, namely the consumption of factors in the exploitation process, with the obtained *effect*, measured by the accountancy by the size of the income, the *result* is obtained, which can be positive-profit or negative -loss.
In the market economy conditions, the efficiency of a company depends to a large extent on the managers' ability to understand and apply modern management principles, methods and techniques. The quality of the management act is a vital condition for the companies to gain competitive advantage and to resist to the competitive mechanisms. The statement is as important as in recent years it was demonstrated that the main factor of bankruptcy of a company is the managers' incompetence and the management mistakes

due to errors in decision-making. In a structural analysis, this factor has a share of 60%, followed by the unfavourable evolution of the market (with a share of 20%), natural phenomena, fire, disasters, earthquakes (with a share of 10%) and other causes (10%) (Ionescu, 2013) [7].

Considering that the bankruptcy comes as a result of the company failure to make its payment obligations and is determined by the lack of liquidity, we can state that the management of the financial activity is the cause of the entrepreneurs' success or failure. (Brezeanu, 2006, Pişleag, 2012) [2, 10].

MATERIALS AND METHODS

The sources of information for this paper were the annual financial and accounting statements of a company with agricultural profile in Ialomiţa county, for the period 2015-2017, with the components: the brief balance sheet, the profit and loss account, the accounting notes, the accounting policies of the company.

As a method, the financial analysis was used, more specifically, the analysis of the company results based on the company balance sheet. The analysis based on the financial balance sheet aims, above all, to highlight this balance state.

Analyzing the financial balance horizontally, it is considered that "maintaining the financial balance is achieved when the permanent resources finance the permanent uses and temporary resources finance the temporary uses" (Georgescu, 2009, Cretu, 2016) [5, 6].

Starting from a certain balance that must exist between the duration of a funded operation and the duration of the corresponding means of financing, the financial balance highlights two main funding rules, namely: permanent needs for the allocation of funds will be covered from permanent capital, in particular from own funds, temporary needs will normally be financed from temporary resources (Brezeanu, 2006, Pişleag, 2012) [2, 10].

Not complying with the funding rules, it will result in a financial imbalance which will either be a stress (pressure, discomfort) for the financial manager, who will be obliged to secure the financing of some assets that must be permanently available to the company from temporary liabilities, or too high of capital acquiring, given that, in principle, short-term capital presents a higher cost over the same time horizon.

Using specific methods and techniques, the financial diagnosis allows the evaluation of the past and present financial situation, based on information provided for making decisions bz the management team, it aims the future. The information needed to make the financial diagnosis is taken from the simplified financial situations which contain: the balance sheet, the profit and loss account, the explanatory notes.

RESULTS AND DISCUSSIONS

The two parts of the balance sheet, containing asset items in close relation with liabilities, reflect the long-term financial balance and the short-term financial balance.

The absolute indicators of the financial balance are: The Working capital (FR); The working capital need (NFR); Treasury (T), Net Situation (S.N.)

The company that provided the information for analysis was established in 2003 as a limited liability company; - is a Romanian legal entity, which develops its activity based on the Law 31/1990 on the establishment of the commercial companies.

Table 1. Structure of crops and evolution of grown surfaces, in the period 2015-2018

Crop	Grown surface -ha/ years			
	2015	2016	2017	2018
Wheat	103	91	86	80
Barley	35	47	43	49
Rape seed	167	204	139	129
Maize	72	35	60	100
Sunflower	41	41	90	60
Lucerne	2	2	2	2
Total	420	420	420	420

Source: Data from the company records.

The main activity of the company is: "Cereals growing (except for rice), leguminous plants and oil seed producing plants - CAEN code - 0111.

From the analysis of the crop structure and the evolution of the areas grown on crops (Table 1), it is noted that during the period 2015-2018, the structure of the crops remained the same as the agricultural area under use.

All crops are grown on fluctuating surfaces each year, as the management team aims to make crops more efficient by performing a rational rotation of crops.

The working capital is that part of the permanent capital intended and used to finance the current operating activity. In practice, when the permanent resources are larger than the permanent needs of money allocating, the enterprise has a working capital fund (International Standards of Financial Reporting, 2011) [8].

This first balance indicator represents all the resources needed to finance the company current activities, and can be calculated using as source the financial balance sheet as well as the functional balance.

The working capital can be calculated as follows:

FRN = Permanent Capital – Fixed assets

Within the studied company, during the studied period (Table 2, Figure 1), it can be noted that the working capital is negative, the decrease being 10.6% in 2017 compared to 2015. Each year, the permanent capital is located below the level of the fixed assets, both structures, compared per percent, record an increase of about 10% in 2017 compared to 2015.

Table 2. Evolution FRN, in the period 2015-2017

Specification	U.M	2015	2016	2017	Evolution indicators (%)
Permanent capital	thousand Lei	1,861.9	1,949.5	1.918,6	10.3%
Fixed assets	thousand Lei	3,345.6	3,461.4	3.469,9	10.4%
FRN	thousand Lei	-1,483.7	-1,511.9	-1.551,3	-10.6%

Source: Financial situations – accounting balance sheet.

From the solvency point of view, the company is under the impossibility to repay the short term debts, with a share of about 70% of total debts.

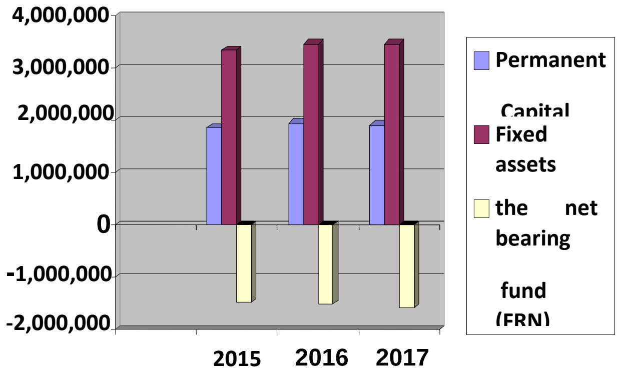

Fig. 1.Evolution of FRN, in the period 2015- 2017 (lei)
Source: Own design based on Balance sheet.

The financial working capital can be further analyzed, according to the structure of the permanent capital, an analysis that highlights the degree to which the financial balance is ensured through own capital. The indicator that reveals this degree of financial autonomy or freedom in making investment decisions regarding the development of the enterprise is its **own working capital** that is the surplus of own capital in relation to net fixed assets. (Pişleag, 2012, Cretu, 2017) [4, 10].

A negative own working capital should not be interpreted as an unfavourable situation, at least in the short term, but only a potential alarm signal for the future.

Starting from a certain balance that must exist between the temporary values and temporary resources, the balance sheet highlights another financial balance indicator named the need for working capital as an indicator of the need to finance the circulating asset.

The working capital need expresses a discrepancy between flows and can be determined as a difference between uses and resources, a difference corresponding to that part needed for the operating cycle that was not funded by the resources generated by this cycle and should be covered by complementary financing.

In other words, NFR represents the money to be run in the company to ensure its operation (after the assets financing), which claims costs that will be recovered when the invoices are paid by the customers.

The working capital requirement is determined as the difference between cyclical

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allocations (current assets excluding liquidity: stocks and receivables) and cyclical sources (short-term debts: operating debts and treasury credits).

Further on, (Table 3, Figure 2) is the evolution of the elements that lead to the determination of the working capital requirement, namely the elements representing cyclic/temporary allocations compared to their cyclical/ temporary sources of financing.

The need for negative working capital indicates an unfavourable situation if it is the result of a temporary interruption in the supply and renewal of inventories of the stocks or in the production activity.

Table 3.Evolution of NFR, in the period 2015-2017

Specification	U.M.	2015	2016	2017
Stocks	Thousand Lei	901,5	942,2	936,5
Receivables	Thousand Lei	608,9	961,8	452,8
Advance costs	Thousand Lei	5,7	5,3	1,5
TOTAL CYCLIC ALLOCATIONS	Thousand Lei	**1,516.2**	**1,909.3**	**1,390.8**
Operating liabilities	Thousand Lei	1,730.8	1,856.1	2,198.3
Advance income	Thousand Lei	1,966.5	2,032.5	1,606.5
TOTAL CYCLIC SOURCES	Thousand Lei	**3,697.3**	**3,888.6**	**3.804.8**
NFR	Thousand Lei	-2,181.1	-1,979.3	-2.414.0

Source: Financial situations – Accounting balance sheet.

The negative value ***(NFR < 0)*** highlights the surplus of the temporary resources in relation to the corresponding needs of the working capital, or temporary needs less than the possible temporary sources of mobilization. Such a situation can be appreciated favourably, if it is the result of the acceleration of the rotation of the current assets and the simultaneous engagement of the debts under favourable conditions for the enterprise (with higher due), that is, the payments were accelerated and payments were diminished.

This is a frequent case in the enterprises with commercial activity, due to supplier loans - much larger than customer loans.

On the contrary, the need for negative working capital shows an unfavourable situation, due to temporary interruptions in the supply and renewal of inventories of stocks or in the production activity or in situations of non-observing the short-term debt pay off.

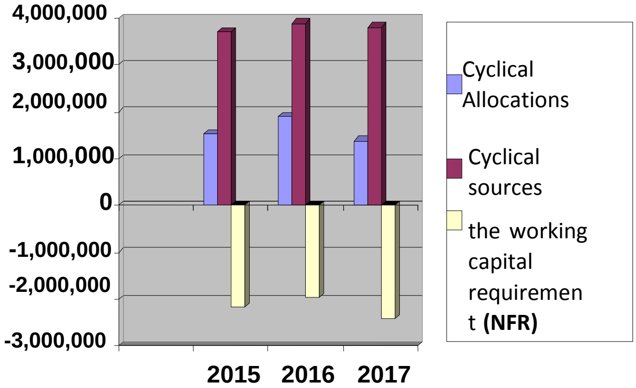

Fig 2.Evolution NFR, in the period 2015- 2017-lei
Source: Own design based on Balance sheet**.**

The Treasury represents the image of short-term money availability and short-term investments come from the current evolution of receipts and payments, respectively the placement of the monetary surplus.

The calculation of the net treasury leads to the confrontation of the working capital with the working capital need, from which the financial balance of the enterprise results and reflects the financial situation of the company both in the short and long term.

The net treasury is determined as the difference between the working capital and the working capital need: **TR = FRN– NFR.**

The positive difference between FRN and NFR highlights the availability of money in bank accounts and cashier accounts.

The reverse situation, namely the negative difference (negative treasury), shows that the company is in financial imbalance at the end of the accounting year, and for the continuation of the activity it has to turn to short-term bank loans.

For the analyzed company, the net treasury is determined by the difference between the working capital and the working capital need.

The net treasury (Table 4) during the analyzed years 2015-2017, decreased by -11.9 %, the highest value being recorded in 2017 by -

832,625 lei and the lowest in 2016 by -467,412 lei, which highlights the company dependence on the external financial resources and thus the company financial autonomy is limited in the short term because the amounts in the bank accounts and the cash office of the company cannot cover the amount of the current debts. This financial dependence should not be implicitly interpreted as a state of insolvency.

Table 4. Evolution of net treasury - TN, in the period 2015-2017

Specification	U.M.	2015	2016	2017	Evolution indicators (%)
FRN	thousand Lei	-1,483.7	-1,511.9	-1,581.2	-10.6%
NFR	Thousand Lei	-2,181,1	-1,979.3	-2,413.9	-11%
TR	thousand Lei	-697.4	-467.4	-832.7	-11.9%

Source: Financial situations – Accounting balance sheet.

The positive difference between the working capital and the working capital need highlights the availability of cash in the bank accounts and in cash accounts and the treasury is positive.

This favourable difference is found in **a treasury enrichment**, as the existence of liquidity allows the repayment of short-term financial debts as well as various efficient and safe placements in the money and/or capital market (Ionescu, 2013) [7]. It is even about **a short-term financial autonomy.**

Not always a positive treasury reflects a favorable situation, the long-term existence of cash availability may be an insufficient use of them.

Starting from the legal approach of the balance sheet, many financial analysts use the concept of net situation, estimating in accounting terms the value of the rights that the owners posses on the assets of the company (Coşea and Nastovici, 2007, Bătrâncea, 2007, Mironiuc, 2011) [1, 3, 9].

The net situation of the company is determined starting from the component elements of the asset (assets owned by the enterprise and receivables) and the liability balance sheet (own capital and debts). The net situation can be considered as a primary or preliminary indicator of carrying out a financial analysis, with the ability to reflect the management of the enterprise. The net situation can be calculated as the difference between total assets and total liabilities: **SN = A - D.**

It can be seen (Table 5, Figure 3) that in the period 2015-2017 there was an increase in total debts of 12.5%, which exceeded the percentage increase of the total asset, of 10.3% over the same period.

From the information presented, it results that within the company the net situation is positive over the three analyzed years, but decreasing by 14% in 2017 compared to 2015; this highlights sound economic management as a result of reinvesting part of the net profit and other capital items.

The increase in the net situation highlights the achievement of one of the objectives of the enterprise, namely maximizing its value.

Table 5. Evolution of net situation - S.N, in the period 2015-2017

Specification	U.M.	2015	2016	2017	Evolution indicators (%)
Total Asset	thousand lei	**5,559.3**	**5,838.2**	**5,723.4**	10.3%
Total debts	Thousand lei	**2,418.3**	**2,573.5**	**3,024.6**	12.5%
SN	thousand lei	3,141.0	3.264,7	2,698.8	-14%

Source: Financial situation – Accounting balance sheet

The net situation can be considered as a primary or preliminary indicator of carrying out a financial analysis, with the ability to reflect the management of the enterprise.

The net situation indicator expresses the asset value achievable at a certain time.

Owners, shareholders and creditors are interested in knowing the net situation of an enterprise. On the one hand, the shareholders and the owners of the enterprise want to know the value they own, and on the other hand, the creditors want to know the achievable asset that constitute the security of their receivables. The net situation illustrates the amounts to the partners or shareholders in case of liquidation.

A company has a positive financial position in case its own capital is higher or at least equal to the debts with economic value.

This condition shows the fact that the enterprise, as a matter of law, has the possibility to pay its obligations to third parties, both during its activity and at its liquidation.

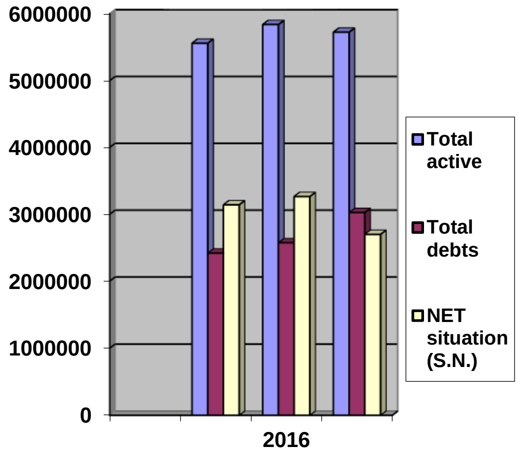

Fig. 3.Evolution of S.N., in the period 2015- 2017 (lei)

Following the determination and analysis of each indicator of financial balance we formulated the conclusions regarding the improvement of the activity in the field analyzed in the company.

CONCLUSIONS

The goal followed by the financial diagnosis based on the balance sheet is the continuous improvement of the activity of the agricultural company, because regardless of the size of a business and its stage of development, each manager needs to know the resources available, how to use them as efficiently as possible to achieve the desired results and which are the actions that bring it gain or loss, so that the right decisions can be made.

The negative working capital denotes a state of financial imbalance, which needs to be analyzed according to the specific of the company activity. This situation reflects the non-compliance with the financing principle, according to which the permanent needs are financed from permanent resources, because part of the temporary resources is used to finance the permanent needs.

We find out that NFR is negative during the entire analyzed period, which would require an urgent supply of the stocks in the following years, but taking into account that the company field of activity, which does not need a surplus of temporary stocks compared to temporary sources of financing, a *negative* value of NFR (stocks + receivables< operating debts) is good, because, even if the company has large debts, there are investments in value adding assets.

The net treasury during the analyzed years highlights the company dependence on the external financial resources and thus its short-term financial autonomy is limited, because the amounts existing in the bank accounts and in the cash office of the company cannot cover the value of the current debts. This financial dependence should not be implicitly interpreted as a state of insolvency.

The *positive* and growing net situation highlights a sound economic management as a result of reinvesting part of the net profit and other capital items. The increase of the net situation highlights the achievement of one of the objectives of the enterprise, namely maximizing its value.

The working capital, the working capital need, the net treasury, the net situation are minimal financial management elements that must be part of the information that the managers receive periodically, especially since the implications of these developments may be negative.

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